Lionberger, Isaac Henry

Deflation: the trouble and how to meet it

St. Louis, Mo.

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Deflation

The Trouble and How To Meet It

By

I. H. LIONBERGER

CHAIRMAN AMERICAN CREDIT-INDEMNITY CO.

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Deflation

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The persistent inflation of the currency by the reserve banks, notwithstanding the termination of the war, should rouse the liveliest apprehension. Today we have nearly three billions of false money in circulation, and day by day its volume is increasing. The pressure of high rates of interest has been ineffectual. A subtle, unperceived influence pushes the country on to disaster, and those in control of the Reserve System seem to lack the courage to take the measures which alone can avert it. The situation is not a new one. The mischiefs which we invite have been suffered by many generations of men; the cause is evident; the cure has been discovered. Nearly fifty years agc, Professor Sumner wrote a book in order that men might not forget such cause and such cure. What follows is quoted from his "History of American Currency."

"There is no invention possible for making paper money as good as gold, no device conceivable for making it elastic, no difficulty connected with it which has not been experienced, no phenomena of its development which we have not abundantly analyzed. The scheme rests upon no facts, appeals to no experience, is deduced from no observa-

tion, but is purely imaginary and speculative. It has a certain plausibility, but all the observed phenomena of paper money go to show that it would make a paper elastic only in one direction. For a nation which has fallen into the blunder of issuing paper money, there are only three courses of action: to go on, to turn back, to stand still. The last is the growing up idea and may be ruled out as impractical. To stand still will inevitably end in drifting toward further inflation. To go on means bankruptcy and repudiation. Each new issue will produce for a time ease and apparent prosperity, to be followed in a short time by a new crisis, a new distress and then a new issue, and so on over again. Reform will then be no longer possible, we must run the course to its bitter end, until the paper disappears as ignominiously as the Continental notes. 327. If we choose the alternative course of going back, it is useless to deceive ourselves in regard to what it involves. If we want specie payments, we must have specie; if we want specie, the entire history before us repeats to weariness that we must get paper out of the way. This is the first condition, and until we are willing to face it, it is useless to discuss resumption. 328.

"We have seen by abundant evidence that the movement of the precious metals from country

to country is not governed by the balance of trade, as is assumed in nearly all discussions of this subject. An economist today who makes an assault on the balance of trade feels as if he were taking a sledge-hammer to break through an open door; but this doctrine is made the starting point of discussing our finances in congress and in most pamphlets and newspapers. 328.

"If we want specie, we must go to work and get it. It is not possible, save by withdrawing a portion of the paper money, to draw it into a country where such money has been issued. No nation has ever had the courage to pursue the right course except England, and she only entered upon it after two or three commercial revulsions which destroyed a large part of the paper, never immoderately redundant. She entered upon the effort under the guidance of a high order of statesmanship and took advantage of the falling prices and business stagnation which followed a crisis. Her resumption was not complete until after the withdrawal of the small notes in 1829. 331.

"If the withdrawal of the paper money should be resolved upon, the best way to accomplish it is the one which is simplest and most straightforward, that is, to raise a surplus revenue and with it cancel the government issues. 332.

"Nearly every nation which has ever used paper money has fixed its amount and set limits which it has solemnly promised never again to pass, but all such promises have been vain. A man might as well step off a precipice intending to stop half way down. 215.

"The question about the exchanges is really this: If the exchanges are adverse to such a degree as to produce a serious and prolonged outflow of the precious metals, where must we look for the cause? Is it due to the balance of payments or to some deterioration of the currency? Or, to put the question in another form, if we desire to produce an influx of gold, to what forces must we look? Must we look to the balance of trade, can we do anything in the matter, must we sit and wait for the balance of trade to turn? Can we bring it about by correcting some error in the currency?" 263.

"Where a country is upon a specie basis, the influx of gold may be left to look after itself. Any outflow of bullion would bring down prices and immediately make a remittance of goods more profitable than of bullion, and if the exportation of bullion were artificially continued, it would reduce prices until a counter-current would set in and restore the former distribution the world over. If all nations used specie, it would be as

impossible for one nation to be drained of specie as for New York harbor to be drained of water by the tide." 264.

"If on the other hand there is an outflow of gold, serious and long continued, accompanied by an unfavorable exchange, it is a sign that there is an inferior currency behind the gold which is displacing it.

"If we wish to produce an influx of gold, there is only one way to do it and that is to remove the inferior currency. As for waiting for the balance of trade to turn and bring gold into a country where there is a depreciated paper currency, one might as well take his stand at the foot of a hill and wait for it to change into a declivity. 265.

"Currency is not capital any more than ships are freight. It is a labor-saving machine for making transfers easy. Banks cannot create wealth; they facilitate its creation by distributing capital. 171.

"The multiplication of currency does not multiply capital. 172.

"The expedition of the New England Colonies against Louisburg was financed by paper money. After its capture, the issues of Massachusetts amounted to £2,466,712. Parliament voted to ransom Louisburg from the Colonies, and paid Massachusetts £138,649, and the governor, Mr. Hutchin-

son, proposed that they should redeem the paper issues at eleven for one, and this course was adopted.

"The shock which was apprehended as the result of deflation did not occur. The only shock was to Rhode Island and New Hampshire, who found their trade transferred to the specie colony and their paper suddenly heavily depreciated.

"Resumption was effected so quietly and easily that none of the fears of the people were realized. Just before resumption trade had been at its lowest ebb. It then began to revive steadily and rapidly and we hear no more of scarcity of money until the next violation of the laws of circulation." 33.

"We have seen in the history of Massachusetts that each new issue of currency was followed in a few years by a new crisis, an outcry about hard times and scarce money. The law which governs this is apparent. The rise in prices and the multiplication of credit operations will absorb any amount of currency whatever. If the amount be fixed, the expansion must come up to and press against this fixed barrier. This pressure will become apparent first at that season of the year at which the normal requirement is greatest. At that time there will be great distress occasioned by the need of withdrawing currency from the use

in which it is then engaged. As it cannot be imported, and the law forbids its increase, there is no relief. It must be withdrawn, and the consequences must be endured. Then it is said that the currency is not elastic and schemes are invented for making it so, but no device can make it elastic. An elastic body is one which will expand and contract. A paper currency never contracts itself. Any device which has elasticity for its object will have expansion for its effect." 220.

"The Continental Congress having no power to tax and its members being used to paper issues, began to issue bills on the faith of the "Continent" in 1775. The bills began to depreciate in 1776. At the end of 1779 Congress was at its wit's end for money. In the spring of 1780 the bills were worth two cents on the dollar, and then ceased to circulate. Specie came into circulation, being brought by the French and English. pp. 43-45.

"Peletiah Webster wrote in 1791: "The fatal error that the credit and currency of the continental money can be kept up and supported by an act of compulsion, entered deep into the minds of Congress and no considerations of justice, religion, policy or even experience of its utter inefficiency could eradicate it. It seemed to be a kind of obstinate delirium, totally deaf to every argu-

ment drawn from justice and right, from the natural tendency and mischief of things, from commonsense and from even common safety. At most its utmost effect was like that of water sprinkled upon a blacksmith's forge, which indeed deadens the flame for a moment, but never fails to increase the heat and force of internal fire. I do not mention these things from any pleasure I have in exposing the errors of my country, but in the hope that our fatal mistake may be a caution and warning to future financiers." p. 199.

"Through the facilities afforded by the abominable paper money system of the time, in 1819, the prodigality and the waste of the speculators were almost beyond belief. "We have heard that the furniture of a single barber possessed by one of these cost $40,000. So it was in all the great cities, ..., ..., ... Vendors of tape and bobbins were transformed into persons of high blood and the sons of respectable citizens converted into knaves of rank. 79.

"Land in Pennsylvania was worth in 1809 $38 an acre; in 1815, $150; in 1819, $35. The note circulation in 1812 was $45,000,000; in 1817 $100,000,000; in 1819 $45,000,000. 80.

"On the 11th of July, 1836, President Jackson issued the famous Specie Circular by which he

ordered agents for the sale of public lands to take in payment specie only. The state of the currency was almost incurably bad, so that it was very doubtful whether the highest skill and wisdom could restore it to soundness. Calhoun considered an explosion inevitable. 130.

"The New York banks suspended specie payments in a body on May 10, 1837. 140.

"In January, 1838, the issues of the New York banks had been reduced from $25,000,000 to $12,000,000 and the banks began to prepare vigorously for resumption. 143.

"Specie payments were resumed May 10, 1838. 145.

"Between 1848 and 1851 the circulation of the banks increased from $128,000,000 to $155,000,000. 174.

"In 1851 there began an export of gold. 175.

"In 1855 the percent of specie to circulation was 14% in the eastern states (181) and the panic followed in 1857. 183.

"Between January 1, 1857 and January 1, 1858, the notes of the banks had decreased from $214,000,000 to $155,000,000. In 1863 they had increased to $238,000,000. 188.

"In 1861 all the banks suspended. 194.

"A bill for an issue of legal tender notes was passed by Congress Feb. 25, 1862. 198.

"Then followed an era of paper money without precedent. Paper money was redundant but fixed in amount. The greenbacks stood at $350,000,000, the national banknotes were limited to $300,000,000; but in 1870 $54,000,000 more were authorized. 214.

"The financial interests of a great nation for an indefinite future were staked upon a desperate resource to tide over a temporary exigency. When the lessons of history were quoted, they were answered by the Flag and the Eagle. When caution was urged in view of future exigencies, it was answered by prophecies of military success. When the need of deliberation was urged, it was answered by clamor in regard to the necessities of government. When it was suggested that irredeemable paper had always wrought ruin, it was answered that our resources were unlimited and that precedent was of no importance. When it was prophesied that the paper would depreciate, that we should not be able to retrace our steps, the prophets of evil were indignantly pointed to the pledged faith of the United States. Whatever strength a nation has is weakened by issuing legal tender notes. One may as well say that it is necessary to open the veins of a weak man who has a heavy physical task to perform. All history shows that paper money is not a temporary re-

source. It cannot be taken up and laid down as we choose. It is a mischief easily done but difficult to cure." p. 201-2.

"Gold began to rise immediately after the issue of the greenbacks. Exchange on London advanced between April 12 and June 23, 1862, from 111 to 121. p. 203.

"The war being ended, the financial question took this form: shall we withdraw the paper, recover specie, reduce prices, lessen imports and live economically, or shall we keep paper money, buy foreign goods and go on as if nothing had happened? 211.

"On October 31, 1865, the greenbacks outstanding amounted to $428,000,000. 211.

"At the suggestion of Mr. McCullouch in 1865, Congress voted to authorize a contraction of $10,000,000 in six months and $4,000,000 the month after that. The operation went on until January, 1868, but in the meantime the national banks put out notes which more than compensated for the greenbacks withdrawn. 212.

"In 1868 outcries began to be heard against contraction by those who were engaged in regular business. Congress forbade further contraction and reversed its policy. 213.

"In 1869 the money market was stringent throughout the year, and was declared in October to be worse than ever for eight years. 216.

"As the stock exchange was the place where the redundant currency was employed, the crisis of 1873 first developed there. 218.

"During the crisis greenbacks were hoarded, which was thought to prove how good they were. 'If the currency consisted of clam-shells and a crisis should come in which it was to be feared that clam-shells might become scarce, clamshells would be hoarded,' says Sumner. p. 219.

There was a crisis in England in July, 1810. p. 251. The Bullion Report was printed in June, 1810. The report was debated in May, 1811. 261.

"The authorities of the Bank of England strenuously denied this proposition, (p. 265) contending that excessive paper issues had nothing to do with the exchanges.

"Among the distinguished financiers who appeared before the Committee, none but Mr. A. Baring were of opinion that the unfavorable exchanges were due to a redundancy of paper money; all the rest were of a contrary opinion. The Chancellor of the Exchequer insisted that no excess of circulation had been proved. p. 274.

Mr. Canning said: "No dream, it must be owned, could be more extravagant than the visions of these practical men who have undertaken to refine away the standard of the currency of the realm into a pure abstraction. There is indeed something ludicrous in the inconsistency and injustice with which they impute a love of abstraction to their opponents, while they are themselves indulging in the most wanton departures from substance and reality. (p. 276.) 'Beware of abstractions,' they say,—and this admonition comes from whom? From the inventors and champions of abstract currency, from those who after exhausting in vain every attempt to find an earthly substitute for the legal and ancient standard of our money, have divested the pound sterling of all the properties of matter and pursued it, under the name of an ideal unit, into the regions of absurdity and nonsense.

"In addition to the motives of policy, I have heard not without astonishment considerations of justice which preclude any systematic reduction of the amount of our paper currency. Such a reduction, it is argued, would change the value of existing contracts and throw into confusion every species of pecuniary transaction. Good God! What is this but to say that the system of irredeemable paper currency must continue forever?

What is it but to say that the debts incurred and the contracts entered into under the old established legal standard of the currency are now to be lopped and squared to an new measure set up originally as a temporary expedient." 277.

"Suppose, for instance, ten millions sterling sufficient to carry on the transactions of the country: fabricate fifteen millions of paper instead of ten, the only consequence will be that the commodities for which it is exchanged will rise fifty percent over their normal price. Make these fifteen millions twenty, the addition will in like manner be absorbed into the enhanced prices of commodities. Excess of currency cannot be proved to the conviction of those who will not admit depreciation to be the proof of it." 278.

The Bullion Report was defeated by 151 to 75.

"Between 1810 and 1814, banknotes of the country increased from 44,000,000 to £48,000,000.

"In 1816, when the revulsion came, the banks failed in great numbers. 284.

"Nothing has been seen since the beginning of the century to compare with the distress of 1811 and 1812, the years following the rejection of the Bullion report. 280.

"In 1814 peace was restored. 283. Enormous exportations were made to the continent and to

the United States. 283. But it was found impossible to drain off the bullion of a foreign country by foreign trade, if it does not want to be drained.

"In 1816, after a long endurance of the war and the dragging misery of 1812-1814, broken only by fitful gleams of prosperity, over-trading prostrated commerce and manufacture together, and agricultural was no better off. 283.

"A crash occurred in 1818 and numerous failures during the winter. By February, the Bank of England circulation had fallen to 25,000,000. In 1819 Parliament appointed a Committee on Resumption. There was a great change in the questions discussed. It was now admitted by all but a very few that the currency was depreciated. This doctrine was disputed by no one save, strangely enough, the directors of the Bank of England. 288. They passed a resolution that they could see no good ground for the opinion that the Bank had only to reduce its issues to obtain a favorable turn in the exchanges. It was agreed on all sides that the movement of resumption should be gradual and careful, if made at all. The question narrowed down to this: is it expedient in view of the effects of suspension which we have experienced, and in view of the benefits of sound currency, to set to work manfully to endure the distress for the sake of the good? 289.

"The contraction of bank issues was so great that the gold premium fell and paper came within a few pence of par. Resumption at this time would scarcely have cost a struggle. No effort of the kind however was made. On the contrary, no sooner was the crisis over than a new expansion was commenced. 285.

"Mr. Peel, opening the debate, said: "Sir Isaac Newton entered upon an examination of the subject, but that great man came back to the old vulgar doctrine, as it was called by some, that the true standard of value consisted of a definite quantity of gold bullion. Every sound writer on the subject came to the same conclusion, that a certain weight of gold bullion with an impression on it denoting it to be of that certain weight and of a certain fineness, constituted the only true, intelligible and adequate standard of value, and to that standard the country must return or the difficulties of our situation would be aggravated." 291.

"The bankers offered arguments to the contrary. Mr. Canning closed the debate by saying that it was the unanimous determination of Parliament that the country should return as speedily as possible to the ancient standard of value. "Loud and universal cries of Hear! Hear!" 294.

"Lord Grenville said that he could show how the miseries of 1816 followed on the issues of the preceding year and how the excessive issues of the country paper, which could not maintain itself like bank paper by legitimate enactment, led to a fearful depreciation and without any fault of individuals, by the force of the system, involved the whole kingdom in one general desolation. Not only its trade and commerce but its agriculture, its landed interests, even classes the most remote from connection with or knowledge of the paper system, found themselves suddenly consigned to total and inexplicable ruin. If their Lordships could see at their bar, not merely the victims of commercial failure but those numerous persons of all ages, sexes and classes who had unconsciously suffered, without even understanding how or whence the evil fell upon them, such a spectacle would fill their lordships with horror. 297.

"The bill was passed and a great fall in prices took place in 1819. 298.

"Thereafter the Bank steadily contracted its, issues, its circulation falling between 1819 and 1823 from £25,000,000 to £18,000,000, and in the meantime its bullion increasing from £4,000,000 to £10,000,000. Specie payments were resumed May 1, 1821. 299. Exchanges became favorable;

confidence was restored; notes flowed to the bank without exerting any pressure on the market. 299.

I have quoted from Mr. Sumner in order to show not merely the conclusions at which he arrived but the facts upon which he relies. What the reserve banks are now doing was done formerly under like circumstances by the Colonies, the Confederated States, the United States, England and perhaps all governments in distress. To each and all of them came the same afflictions. Like troubles will come to us unless, taking heed in time, we retrace our steps. We can neither go on nor stand still. The notes put out are promises to pay gold. These promises do not now trouble us, because no one has a motive to demand performance. The available gold resources of the reserve banks are however but forty percent of the promises outstanding. If for any reason, at any time, it shall become profitable to withdraw gold from the treasuries of the banks, or if at any time a doubt shall arise with respect to their ability to pay, trouble will follow.

As Mr. Sumner explains, no country can rely upon trade to replenish its gold where its paper currency is redundant. Notwithstanding its enormous excess of exports, gold is leaving this country in a steady stream. The world owed us at the end of 1919 four billion dollars, yet we shipped out more

gold than we got in. Something is wrong. Inflation has gone too far. Someone, somewhere, discredits our currency.

I know that many ingenious and expert explanations of the outflow of gold have been put forward, but such explanations have always been forthcoming under like circumstances from like sources. The financial magnates of Lombard street were wrong in 1811. Time proved them wrong, and a shocking financial panic. No man of sense will allow that we should for any legitimate purpose export gold when foreign nations owe us four billions of dollars of gold. It is not going out because gold will purchase more elsewhere or is worth more elsewhere. The cheapness of our goods induced the buying which resulted in such unprecedented exports. The cause is elsewhere. History tells us that it is inflation.

After the termination of the Napoleonic wars, England sent out great quantities of goods but got no gold for them. Wise men said then her paper money prevented the importation of gold. The bankers then were of another opinion. They were confuted by disaster. When specie payments were resumed, gold flowed in.

We are fast drifting toward danger. If we do not stop and turn back, we shall strike upon the

rocks. What the statesmen of England could not prevent, a violent and devastating panic arrested. Must we wait for like correction?

Those in control of the reserve system say that they cannot stop, that they have tried and failed, that they raised the rate of interest, but the demand for notes increased, and that they cannot refuse accommodation without arresting trade. They are mistaken! They can stop; they can turn back. Instead of doing so, they have added to their difficulties. What is the meaning and effect of a high rate of interest? Does it not add to the cost of doing business? Is not the reserve system by its advance in rates becoming part of that vicious circle which hedges in the high cost of living? Materials have advanced, wages have advanced, and now rates of interest have advanced. How can a merchant extricate himself save by charging more for his goods? Will not the effect of still further inflation and still higher rates of interest necessarily be to still further advance prices? How can this evil be arrested, if the great power of the reserve banks be ranged behind the profiteer and the wage earner?

I say we can turn back. There are several ways of accomplishing deflation. If the government will offer to its creditors a refunding, non-taxable bond, redeemable after a certain period at par,

bearing say four percent interest; that is, a bond which will invite and deserve the confidence of investors, all bonds now outstanding will instantly go to par and all those obligations predicated upon subscriptions to the government loans and involving the issue of reserve notes will be paid, and all such notes will be paid. The 3½% non-taxable bonds of the United States are now selling at about par. Men fear a creditor who promises and will not pay what he promises. To promise 4¼% and take back one-half or one percent by taxation, is not to fulfill the promise. Today the Reserve Bank, a public institution, not organized for profit, is punishing patriotism by exacting for itself 4¾% and inducing its members to exact six per cent on obligations which yield but 4¼%. No wonder the bonds of the government have depreciated. The slender income derived from them is taxed; the rate of interest charged for carrying them has advanced and forced selling has been the result.

If the present indebtedness of the country be so refunded and the notes of the reserve banks be so reduced, what should be the effect on business and finance? Raw material and capital will cost less and prices will decline. The money market will relax, gold exports will cease and a panic will be deferred if not averted.

But the reserve banks cannot control Congress, it will be said. This is true. There is, however, another way. If tomorrow the Reserve Board shall prohibit the issue of any more notes under any circumstances, pledging itself at the same time not to call in those now employed for legitimate purposes; if it shall go further and announce that it proposes to take over and destroy all unneeded notes which shall be paid into its treasury, and continue to pursue this policy until its gold reserves shall reach sixty or sixty-five percent of its current obligations, what should be the consequences? Will not business gradually adjust itself to deflation?

Business was never so profitable. Why should it be impossible or even difficult for the borrower to pay his debts with the fruits of his sales? Men today must borrow more because prices are advancing; when prices fall, they will need less.

It is high time to turn back. If we do not, and continue to inflate, and raise the rates of discount, and prices and wages continue to advance, what will be the end? Foreign buying in America will cease, gold will go out, suspension, dishonor and panic will follow. Credit inflation and price inflation and wage inflation and note inflation have gone far enough. Shall we push it further until the bubble bursts, or turn back while we can?

I. H. LIONBERGER.

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